Externalities

Economics

Costs and benefits that fall on people outside the transaction.

Negative externality

- Cost imposed on third parties
- Pollution, congestion, noise
- Social cost exceeds private cost
- Market over-produces
- Tax or regulate to correct

Positive externality

- Benefit received by third parties
- Vaccination, education, research
- Social benefit exceeds private benefit
- Market under-produces
- Subsidise to correct

THE DIFFERENCE THAT MATTERS

The correction aims to make the decision-maker face the full social cost or benefit of their choice.

Coase argued that with clear property rights and low bargaining costs, parties can resolve externalities without a regulator.